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Supreme Court, U.S.
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In The
Supreme Court of the United States

ALAN DeATLEY and DEBRA DeATLEY,
husband and wife,

Petitioners,

vs.

LYNN BARNETT and MARLENE BARNETT,
husband and wife, LOOKOUT POINT PARTNERS,
a Washington partnership,

Respondents.

On Petition For Writ Of Certiorari To The Supreme Court Of The State Of Washington

PETITION FOR WRIT OF CERTIORARI

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QUESTIONS PRESENTED FOR REVIEW

1. Whether 11 U.S.C. § 541 can be interpreted for purposes of applying the Washington State doctrine of judicial estoppel as requiring individual debtors to schedule on their asset schedules (disclose) assets of a closely held corporation, the stock in which was clearly disclosed.

2. Whether or not the application of the Washington state doctrine of judicial estoppel in this case operates to deny to Debtors the effect of their bankruptcy discharge under 11 U.S.C. § 524.

3. Should Washington State debtors be held to a different schedule disclosure standard than are debtors in other states under federal bankruptcy law.

PARTIES TO THE PROCEEDINGS

The parties to the action are the Petitioners/Appellants, Alan DeAtley and Debra DeAtley, husband and wife. Respondents/Appellees, Lynn Barnett and Marlene Barnett, husband and wife; LOOKOUT POINT PARTNERS, a Washington partnership, Respondents/Appellees.

The corporate disclosure required in Rule 29.6

None Required.

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OPINION BELOW

Opinion below of the Supreme Court of the State of Washington entered March 8, 2006, Appendix A-12, is reported at 156 Wash.2d at 1021, 4-2006 LEXIS. The Opinion of the Court of Appeals, State of Washington, May 17, 2005 (Appendix A-1-8) will be reported at *DeAtley v. Barnett*, 127 Wa. App 478, 112 P.3d 540, 2005 Wash. App LEXIS 1022. Petition for review to the Supreme Court of the State of Washington was filed on July 20, 2005, Appendix pp. C-23-55, and was denied. Reconsideration Denied 2005 Wash. App. LEXIS 1557.

JURISDICTION

The Opinion of the Supreme Court of the State of Washington was entered on March 8, 2006. Jurisdiction of this Court is invoked under 28 U.S.C. § 1257 and Supreme Court Rule 10. The decision of the state court of last resort has decided an important question of federal law that has not been, but that should be, settled by this Court. Petitioner's Motion for Reconsideration was filed on March 27, 2006, Appendix pp. C-1-22, and was denied.

The letter of the Supreme Court of Washington denying consideration of Petitioners' Motion for Reconsideration was later received, dated May 27, 2006. Subsequently, a letter of the Supreme Court of Washington was reviewed denying any award of attorneys fees dated March 31, 2006.

STATUTES INVOLVED

The statutes involved in the case are set our verbatim with appropriate citation in Appendix B. They are 11 U.S.C. § 541 and 11 U.S.C. § 524. Pertinent provisions of the statutes involved are set forth in Appendix B, pp. B-1-51.

STATEMENT OF THE CASE

On or about January 1, 1988, DeAtley and Barnett executed a contract (DeAtley Agreement). The DeAtley Agreement provided that if Barnett later transferred a contract interest which he had in real property to any future party, DeAtleys would have a first refusal right to purchase the assigned interest.

In January 1990, DeAtleys assigned their interest in the DeAtley Agreement to their wholly owned company, Wild Ones, Inc., d/b/a AD3 Company (AD3 Company). Approximately two years later in March 1992, the DeAtleys filed for bankruptcy. On their bankruptcy schedules, the DeAtleys correctly disclosed they owned all AD3 Company's stock. Later, particulars about this company's debts and assets were also disclosed by the DeAtleys to their trustee. Because two bankruptcy creditors placed at issue AD3 Company's finances, DeAtleys' bankruptcy lawyer confirmed that she specifically discussed the DeAtley Agreement first refusal rights and AD3 Company obligations under the DeAtley Agreement with the bankruptcy trustee. It is undisputed that because of the two creditors' inquiries, the trustee conducted an investigation into AD3 Company's assets, and eventually concluded that AD3 Company's known assets and debts were "evenly

matched." Accordingly, by later pleading filed September 22, 1992, the trustee subsequently abandoned all stock in AD3 Company back to the DeAtleys.

It is undisputed that during the bankruptcy DeAtleys never knew DeAtley Agreement first refusal rights were exercisable, or that Barnett had breached the parties' contract by not informing DeAtleys that in 1991 the purchase contract for the property had been assigned by Barnett to a new formed partnership.

Not until approximately 1995, several years after DeAtleys' personal bankruptcy had been concluded, did DeAtleys first learn that DeAtley Agreement first refusal rights had matured and/or lawsuit claims might exist.

Although DeAtleys did not own the DeAtley Agreement during the bankruptcy, post-bankruptcy when AD3 Company dissolved, the ownership of its remaining assets, including the DeAtley Agreement, returned to DeAtleys.

At no point during the bankruptcy and at no point post-bankruptcy did DeAtleys ever claim the DeAtley Agreement had terminated or that Barnetts or AD3's contract rights as against each other were in any way effected by DeAtleys' bankruptcy.

To subsequently support their request for lawsuit dismissal, the respondents have argued the DeAtleys on their personal bankruptcy schedules had to identify not just their ownership of AD3 Company stock, but all assets AD3 Company now owned, including the DeAtley Agreement, and further had to disclose that as part of the DeAtley Agreement there were first refusal rights that might have value.

In fact, the respondents' entire judicial estoppel argument is based upon the assertion that federal law required this information to be put on DeAtleys' personal bankruptcy schedules and that because federal law was allegedly breached by DeAtleys' failure to do so, judicial estoppel applies.

It necessarily follows, however, that if the respondents are wrong about what federal law required DeAtleys to do, then judicial estoppel does not apply.

These questions were raised in the trial court, and raised in the Court of Appeals of the State of Washington, as is evident from the published opinion of the Court of Appeals of the State of Washington, Appendix pp. A-1-8, entered on May 17, 2006. It was raised on the Petition for Review to the Supreme Court of Washington, and argued therein as predicate to the Order, Appendix pp. C-23-55.

The Court of Appeals of the State of Washington and the Supreme Court of the State of Washington held that Bankruptcy Code required the Debtor to disclose the Barnett option or contract right which was owned by the corporation whose stock was disclosed as a separate asset in the bankruptcy schedules, to the Court and to the trustee, and that a failure to do so estopped DeAtleys under the doctrine of judicial estoppel under the laws of the State of Washington from later asserting a contract breach claim.

ARGUMENT AMPLIFYING REASONS FOR ALLOWANCE OF WRIT

The decision of the Supreme Court of Washington, upholding the decision of the Washington State Court of Appeals is based on an incorrect interpretation of federal statute.

A. Lawsuit Claims or Contract Rights Belonging to a Non-Debtor Corporation or Partnership Need Not Be Listed as Assets on a Debtor's Personal Bankruptcy Schedules.

Rule 11 U.S.C. § 541 defines what is or is not property of a debtor. It clearly does not require disclosure of assets of closely held corporations of which debtors are shareholders where the stock is disclosed.

The answer to this question under federal law is unequivocally no. The federal bankruptcy court in the case *In re Russell*, 121 B.R. 16 (Bankr. W.D. Ark. 1990) confirmed that corporations have a separate legal existence from shareholders and that accordingly, while a trustee may have an equitable interest in the assets represented by the corporation's stock, the assets themselves are not part of the property of the estate and a trustee has no right to possess directly the underlying assets. This same conclusion was reached by the 7th Circuit in the case *Fowler v. Shadel*, 400 F.3d 1016 (7th Cir. Wis. 2005). *See also, In re Atkins*, 1992 U.S. App. LEXIS 32032, Reported as Table Case 979 F.2d 854, 1992 U.S. App. LEXIS 35749 (9th Cir.), In that case, the court held that while the interest held by a debtor in a partnership or corporation would be the property of the estate, the underlying assets of the partnership or corporation are not part of the

property over which the trustee has control. (*See also In re People's Bankshares Ltd.*, 68 B.R. 536, 539 (Bankr. N.D. Iowa 1986)). The federal district court in Washington has also upheld that causes of action including shareholder derivative suits are the intangible assets of a corporation, and are not the property of an individual shareholder. (*See, Turner v. Officers, Directors and Employees of Mid Valley Bank*, 712 F. Supp. 1489, 1497 (E.D. Wash. 1988)).

As further federal authority for this proposition, DeAtley would also cite the court to *In re Walker*, 198 B.R. 476 (Bankr. E.D. Va. 1996). In that case, the debtor, Robert Walker, was part owner of a partnership known as the "Walker Partnership." Mr. Walker filed a Chapter 11 bankruptcy petition, and proposed and had a plan confirmed.

Post-confirmation, the Walker Partnership, filed suit against a creditor lender, NationsBank, seeking $10 million in damages for the partnership under a lender liability claim. This suit wasn't filed until three years after the underlying bankruptcy plan had been approved and the bankruptcy file closed.

As in this case, the defendant bank subsequently asked that the state suit be dismissed upon a number of grounds, including judicial estoppel. Addressing this issue, the court said:

> Much of NationsBank argument focused on the fact that the cause of action was not disclosed by the debtor. The failure of the debtor to disclose the potential cause of action in his bankruptcy schedules, disclosure statement or plan

> of reorganization does not carry dispositive weight under the facts of this particular case.

Walker at 479.

The court noted:

> A debtor cannot be expected to unerringly predict the future, but rather must provide information on all factors known to him at the time that bear upon the success or failure of the proposals set forth in the plan. *In re Ligon*, 50 B.R. 127, 130 (Bankr. M.D. Tenn. 1985) [Citation omitted]. *The facts before the Court are that the cause of action was not the debtor's, rather it was that of the Walker Partnership. The debtor was to have been a guarantor on the proposed loan and was a general partner of the Walker Partnership, but that still does not make it his cause of action to assert.*
>
> The debtor's interest in the partnership was fully disclosed in the schedules and plan of reorganization and we hold that the debtor was under no duty in the case *sub judice* to disclose this potential cause of action against NationsBank. [Emphasis added.]

In decision footnote 7, the court further said:

> *The plan discloses thirteen related entities of the debtor. The plan confirmation process would be hopelessly complicated were the debtor required to disclose every detail about related entities. This would have the potential to lead to situations where a case would turn into a "global" bankruptcy dealing with every entity of the debtor. In our view, this is not what the disclosure*

> *requirements of the Bankruptcy Code contemplate.* [Emphasis added.]

Walker at 480.

Almost identical facts are presented by this case. Here, under federal law AD3 Company, not DeAtleys, owned the DeAtley Agreement. To the extent any potential lawsuit claim might exist, AD3 Company, not DeAtleys, owned that claim. At the time of the DeAtleys' bankruptcy, the record proves that DeAtleys had no notice the contract's first refusal rights had matured, making the contract a valuable corporate asset. As noted above, however, the fact AD3 Company owned the contract option nevertheless was fully disclosed to the trustee. The DeAtleys, no more than the trustee, had the "crystal ball" ability to know that several years in the future, information would be discovered to support that contract option rights had matured. Given these proven facts, to now suggest that federal bankruptcy law required DeAtleys to "unerringly predict the future" by stating on schedules that a contract right owned by his non-debtor company might someday ripen into an asset or a lawsuit claim, is to put it mildly, unreasonable, and as the *Walker* court noted, inconsistent with the disclosure obligations imposed by federal law. Yet the Superior Court, Court of Appeals, and now as a practical matter, Washington's Supreme Court, have all affirmatively imposed this obligation upon DeAtleys and other similarly situated bankruptcy debtors, as a consequence of the case orders which have been entered.

Finally, even less justification for applying judicial estoppel exists in this case than existed in *Walker*. Here, both prior to and during the bankruptcy, it is proven that DeAtleys had no knowledge any lawsuit claims or potential lawsuit claims existed or that first refusal right had

matured. In contrast, Robert Walker admitted he knew of the facts supporting the underlying NationsBank lawsuit prior to his bankruptcy, because they took place in 1989 and 1990.

That claims or assets belonging to non-debtor companies are not "property of the debtor" and accordingly are not part of the estate for scheduling purposes is a well-settled under federal law.

For example, the bankruptcy court in the case *In re Magnani*, 223 B.R. 177 (1997) addressing this specific issue in the context of a discharge denial proceeding specifically upheld:

> While a debtor may be denied a discharge under § 727(a)(4) for a failure to schedule his interest in a separate business entity, failure to schedule property belonging to another entity is generally not grounds for denial of discharge.
>
> . . .
>
> Bank alleges in ¶ 9(a) of the complaint that Magnani made false oath by omitting information from his statement of financial affairs. *The alleged omissions were not material to Magnani's case because they involve assets and transactions of the partnership, a non-debtor entity. Magnani disclosed his interest in the partnership on his schedule B in answer to question 13. Magnani is entitled to summary judgment on Bank's claim under § 727(a)(4).* [Emphasis added.]

Magnani, id. at 184.

Similarly, in the case *In re Beeber*, 239 B.R. 13 (1999), the court said:

> However, Plaintiffs fail to meet their burden of proving, as required by § 727(a)(2), that the Debtor "transferred, removed, destroyed, mutilated or concealed – (A) *property of the debtor . . . or,* (B) *property of the estate.* 11 U.S.C., § 727(a)(2). [Emphasis added]. The Plaintiffs' claim that the Debtor's conveyance of his stock interest and goodwill of RBPC to himself constituted a misappropriation or transfer by the Debtor of his own property. *An examination of caselaw finds that § 727(a)(2) requires that the property in question be property of the Debtor or property of the estate, not merely assets of a corporation where the Debtor is a shareholder of that corporation.* [Emphasis added.]

Beeber at 26.

Addressing this same issue, the Tenth Circuit Court of Appeals has held:

> *The words: "property of the debtor," are not the same as "property in which the debtor has a derivative interest." To the contrary, the language of the statute is sufficiently circumscriptive to eliminate such an interpretation.* MBank contends the Bankruptcy Code defines "property" to include equitable interests of the debtor, 11 U.S.C., § 541(a)(1). Hence, the creditor maintains the transfer of an asset of a corporation is the transfer of property in which a stockholder has an equitable interest to which § 727(a)(2)(A) would extend. We disagree.
>
> *Congress intended to limit the reach of § 727(a)(2)(A) only to those transfers of property in which the*

> *debtor has a direct proprietary interest. MBank's argument to the contrary is creative, indeed ingenious, but it is not persuasive, and the district and bankruptcy courts correctly so concluded.* [Emphasis added.]

In re Thurman, 901 F.2d 839 (C.A. 10 (Okl.) 1990); *See also, BPS Guard Services, Inc. v. Woodhead*, 172 B.R. 628, 633 (Bankr. D.Neb. 1994); *Riumbau v. Colodner*, 147 B.R. 90, 93 (Bankr. S.D.N.Y. 1992); *Cit Group/Factoring Manufacturers Hanover, Inc. v. Srour*, 138 B.R. 413 (Bankr. S.D.N.Y. 1992); *In re Wong*, 291 B.R. 266 (Bankr. S.D.N.Y. 2003).

As these federal cases made dispositively clear, assets belonging to a debtor's non-bankruptcy partnership or corporations are not under federal law the "property of the debtor" and since only property of the debtor must be listed on schedules in 11 U.S.C. § 541(a), there are simply no grounds for the Court of Appeals or for Washington's Supreme Court to now conclude that the DeAtley Agreement or any contingent lawsuit claim which might arise from the DeAtley Agreement had to be listed by the DeAtleys on the schedules in their bankruptcy. Absent a requirement to disclose or list such information on schedules, there simply is no fact or law that would now support a judicial estoppel bar.

Further, the admitted disclosure of the DeAtley Agreement's existence and right of first refusal to the bankruptcy trustee specifically prevents judicial estoppel from being an issue.

A case particularly on point is the recent case *In re Bargar*, 279 B.R. 900 (Bkrtcy. N.D.Ga. 2002). In that case, a debtor admittedly had a personal lawsuit claim which she had filed against her employer, and which admittedly

was not disclosed on her later filed bankruptcy schedules. At her subsequently scheduled § 341(a) creditor meeting, however, claim existence was specifically brought to the Chapter 7 trustee's attention.

Notwithstanding her verbal disclosure, the trustee subsequently issued a no distribution report, confirming there were no assets which could be recovered for the creditors' benefit. As in this case, although debtors' counsel and the debtors both recalled disclosing this information to the trustee and so testified, by the time of the hearing, the transcript of the § 341 meeting had been lost and the trustee did not appear at the motion hearing to provide any added information about what had occurred.

After discovering this scheduling omission, the defendant moved to dismiss the state case upon the grounds of judicial estoppel. Analyzing this issue, the federal court had no difficulty in confirming that judicial estoppel did not apply. The court stated:

> Debtor in the instant case voluntarily disclosed the claim to the Chapter 7 trustee who is responsible for pursuing it on behalf of creditors in the estate. There was no concealment. Debtor was not "caught" after being challenged.
>
> . . .
>
> *In any event, although debtor did not amend her schedules to list the litigation as a matter of technical bankruptcy pleadings, her voluntary disclosure of it to the Chapter 7 trustee at the section 341 meeting had the same substantive effect of an amendment from the standpoint of the Chapter 7 trustee's knowledge and duties.* The claim was (and is) property of the estate under 11 U.S.C., § 541, and the trustee had authority to pursue it

> under Fed. R. Bankr. P. 6009. Ultimately, it is the trustee's duty to investigate the lawsuit as property of the estate – its merits, its posture, and its value to the estate. Debtor's amendment of her schedules would not have changed the trustee's knowledge of the claim or his duties.
>
> . . .
>
> Debtor had litigation counsel and bankruptcy counsel who were advising her as to her rights and duties. Had her counsel prepared an amendment to her schedules for her, she would presumably have signed it and it would have been filed, as the Federal Rules of Bankruptcy Procedure authorize. [Citation]. Because counsel did not prepare an amendment admittedly because of oversight, she justifiably could nave concluded that she had no further obligations. It would be patently unfair to attribute counsel's error to debtor in these circumstances. Her counsel's failure to amend the schedules does not render debtor's conduct offensive and, in the circumstances of this case, was nothing more than inadvertence on counsel's part. Clearly, neither debtor nor debtor's counsel acted with an intentional or manipulative disregard of the legal system. . . . [Emphasis added.]

Bargar at 906-907.

Here, as in *Bargar*, the record facts are not disputed. The Chapter 7 trustee was told of the DeAtleys' contract and first refusal rights. The trustee later probably investigated the company's debts and assets, an investigation that went far beyond just the DeAtley Agreement, before concluding that in his judgment and to his knowledge, the company's debts and assets were "evenly matched" so that

AD3 Company stock had no value. Here, as in *Bargar*, given the trustee's conduct following disclosure, it is impossible to conclude that any amendment to DeAtleys' bankruptcy disclosure pleadings would have made any difference to the administration of the case. Accordingly, the appellate court's dismissal of DeAtleys' claim as a consequence of alleged judicial estoppel was in error.

Indeed, the principal difference between *Bargar* and the present case is that in *Bargar*, the lawsuit claim was admittedly owned personally by the debtor and was by definition, "property of the estate," while in this case, by definition, the contract and potential lawsuit claim at issue *weren't property of the estate* for which any disclosure duty was imposed. (*See* preceding section). It follows that this court must accept review so that federal law is now fairly considered and properly applied, not just for DeAtleys, but for all similarly situated later Washington debtors who deserve to be equally treated under applicable federal bankruptcy law.

CONCLUSION

In conclusion, the Court should review this case because of the undermining of the federal statute determining what is or is not property of the estate. Further this decision makes possible the application of judicial estoppel in this case in such a way that the Appellants are denied the benefits of their discharge.

Respectfully submitted,

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